DD/A
85-3910/1

Deputy Director
for Administration

19 November 1985

File 60-2

Paul,

We sent the enclosed to the Domestic Policy Council. Best wishes for a favorable response.

Sincerely,

STAT

Harry E. Fitzwater

The Honorable Paul Trause
Deputy Administrator
General Services Administration
Washington, D.C. 20405

DDA/HEFitzwater:rf (19 Nov 85)
Distribution:
Orig - Addressee
1 - D/OL
1 - DDA Subject
1 - DDA Chrono
1 - HEF Chrono

Sanitized Copy Approved for Release 2010/09/07 : CIA-RDP88G00186R000901160002-7

Central Intelligence Agency

Washington, D.C. 20505

85-3910

18 NOV 1985

MEMORANDUM FOR: Domestic Policy Council

FROM: Director of Central Intelligence

SUBJECT: Alternative Financing for Federal Buildings

1. I understand that on 19 November 1985 the Council will consider a proposal by General Services Administration (GSA) that would provide alternative financing for Federal buildings. We have studied GSA's proposal and believe it has tangible merit. As you may know, the Central Intelligence Agency (CIA) is located in [redacted] buildings in the Washington metropolitan area. Not only does the wide dispersal of buildings result in gross inefficiencies, increased transportation costs, but of major significance is the cost associated with all the required security measures for each of these buildings. The new building currently under construction at CIA will not meet all of our future requirements for buildings external to our Headquarters' compound. Therefore, a consolidation of Federally-owned buildings as proposed by GSA would result in significant cost savings and increased efficiencies for this Agency.

STAT

2. I would like to offer my support to the GSA proposal.

William J. Casey
Director of Central Intelligence

ORIG:DDA:HEFitzwater:be:15 Nov 85
Distribution:
0 - Adse
1 - ER
1 - OP
1 - OL
1 - DDA Subj
1 - DDA Chrono
1 - HEF Chrono

Administrator
General Services Administration
Washington, DC 20405

I
N
F
O

November 15, 1985

MEMORANDUM FOR DOMESTIC POLICY COUNCIL

FROM: TERENCE C. GOLDEN
ADMINISTRATOR

SUBJECT: Alternative Financing for Federal Buildings

This memorandum discusses a major financing issue with respect to the management of federal buildings. I believe that this issue should be presented to the Domestic Policy Council in the near future.

Statement of the Issue

The federal government's rental costs are extremely high ($900 million per year) and are escalating rapidly, because lower cost leases are scheduled to expire over the next several years. If nothing is done, the government's total lease bill will grow to $2 billion per year by 1995.

Government-owned space is more economical for several reasons. First, when the federal government owns buildings, it benefits from lower interest rates for debt financing than are available to private developers. Second, leasing a facility requires the federal government to pay property taxes; owning the facility eliminates that expenditure. Third, government ownership negates a developer's profit, a cost typically passed on to a lessee. Fourth, by owning a facility the government receives all of the benefits of owning an appreciating asset. Fifth, government ownership eliminates the tax shelter advantages available to the developer when the government is leasing the facility.

Our heavy reliance on leasing space has made it more difficult to accomplish the President's program for reducing space costs and realizing management efficiency through consolidating agency operations.

Therefore, a critical issue is how to increase the amount of government-owned space.

Dimensions of the Current Problem

Due to a lack of capital investment, the federal government has relied heavily on renting facilities, with these results:

-- Total rental property has grown from 41.4 million square feet in 1964 to 88.9 million square feet in 1985.

-- 49% of the federal work force is in leased space today.

-- Since 1975, only $947 million has been made available to acquire or construct federal buildings. This represents less than five percent of the total costs of managing the government's buildings during that time.

It should be understood that the planned move from leased to owned space would not represent a growth in government. On the contrary, GSA and federal agencies are pursuing a Presidential initiative to reduce the amount of space occupied by federal agencies from 160 square feet per person to 135 square feet per person. This represents an aggregate reduction of 20 million square feet, or twice the office space in downtown Minneapolis.

Benefits of Ownership

There are significant financial advantages to the federal government from owning its buildings:

(a) Property Taxes -- State and local property taxes are approximately one percent of the value of the asset per annum. When the federal government leases, its rent payments reflect the owner's obligation to pay these taxes. Under ownership, the federal government does not pay such taxes.

(b) Debt Service Costs -- Under ownership, the federal government will finance its debt service costs at favorable rates which range today from 7% (short-term) to 10.5% (long-term). These rates represent the pre-tax interest paid by Treasury when borrowing from the public. The private sector must pay a rate of approximately 13%. These higher financing costs are passed on to the lessee by the developer.

(c) Equity Buildup -- Buildings are appreciating assets; a policy of ownership takes advantage of this appreciation, while leasing offers no comparable benefit. To illustrate, a building of one million square feet costing $100 million today will be worth $324 million in thirty years, assuming an inflation rate of 4%.

(d) Developer's Profits -- When leasing, the federal government's rent payments include a profit. By owning the facility, the government avoids this expenditure.

(e) Tax Benefits -- When owning, the federal government avoids the costs associated with the significant tax advantages available to the developer. They include favorable building depreciation provisions and capital gains treatment upon sale.

GSA has conducted a number of cost comparisons of individual projects to determine the specific financial advantages of ownership. The results are dramatic. To illustrate, constructing a building of one million square feet in Oakland, Ca. will save $100 million (discounted) when compared to leasing over a 30 year period. The projected discounted savings of $100 million for the Oakland project is comprised of: (a) property taxes -- $14 million, (b) debt service costs -- $27 million, (c) equity buildup -- $20 million, (d) developer's profits -- $23 million, and (e) tax benefits -- $16 million.

In addition to these direct financial benefits, ownership will facilitate the program of reducing overall space requirements. Space reduction is heavily dependent upon the consolidation of facilities, which is accelerated by ownership.

The consolidation and collocation of agency operations will also result in significant savings in travel, communications, and administration for affected agencies. Today, GSA manages 57 leased locations per million square feet of space. This compares with 12 locations per million square feet in government-owned buildings.

The need for consolidation and collocation is significant, and a major concern of several Departments. As an example, thirteen Cabinet Departments in the National Capital Region are in 442 locations. The Department of the Treasury is in 56 locations; Justice is in 58 locations. As a result, GSA is pursuing a collocation policy with all major federal agencies.

When fully implemented, GSA anticipates that the policy of ownership will result in the federal government owning in the range of 70-80% of the facilities it occupies. Situations will exist where leasing represents the preferred alternative, and indeed the ownership vs. lease decision must be made on a case-by-case basis.

To achieve greater ownership of space and the resultant savings quickly, GSA favors acquiring, as opposed to constructing, buildings. This strategy will avoid higher costs associated with the construction of public facilities that are the result of numerous legal and regulatory requirements concerning labor and building specifications.

Financing Alternatives for Greater Government Ownership of Buildings

GSA has examined several major strategies for increasing government ownership of buildings:

1. Increase GSA's acquisition and construction budget.

2. Finance new construction and acquisition through the Federal Financing Bank.

3. Lease buildings from municipalities with a purchase agreement at the end of the lease period.

4. Lease buildings from developers with a purchase agreement at the end of the lease period.

Increase GSA's acquisition and construction budget

Under this option, GSA would budget for the funds required to acquire and construct buildings over the next five years. The federal government would gain the full benefits of ownership. Borrowing costs are the lowest of any option, as they reflect Treasury's cost of funds.

The major disadvantage of this option is that there would be a dramatic increase in outlays in the GSA budget over the next five years for capital acquisition. The outlay impact, compared to business as usual, is as follows:

1987	1988	1989	1990	1991	1992	1993	1994	1995
438	530	996	979	961	362	89	-430	-722

(Note: Net outlay savings over the period FY 1987-2016 would be over $12 billion.)

Use Federal Financing Bank

Under this strategy, GSA would finance new construction and acquisition through the Federal Financing Bank.

Advantages:

1. This is a low cost approach. Borrowing costs are the Treasury rate plus one-eighth percent.

2. Borrowings are tied directly to assets purchased.

3. This option distinguishes between a capital and operating budget. Future generations will pay for the use of assets from which they draw direct benefits.

4. If the FFB remains off-budget, there will be a significant reduction in outlays and the deficit, as follows (dollars in millions):

1987	1988	1989	1990	1991	1992	1993	1994	1995
--	-136	-157	-135	-138	-248	-359	-492	-599

Disadvantages:

1. Loans from the Federal Financing Bank may increase outlays and the federal deficit in the near future if these expenditures are reflected on-budget. Outlay impact, compared to business as usual, is as follows (dollars in millions):

1987	1988	1989	1990	1991	1992	1993	1994	1995
438	531	997	981	964	366	94	-424	-715

Lease from municipalities with purchase agreement

Under this strategy, GSA would enter into agreements with municipalities and/or non-profit organizations, such as the Pennsylvania Avenue Development Corporation, to acquire or construct a facility. The municipality or non-profit organization would raise the capital required; their borrowing would be secured by a GSA lease over the next thirty years.

Advantages:

1. This is a low cost alternative that can be implemented quickly.

2. Represents a partnership effort between federal and local governments.

3. Savings, which would result from direct ownership, will accrue to the federal government. We avoid property tax payments, developer fees, and tax shelters. We obtain low debt service rates and achieve equity buildup.

4. Requires no capital budget; outlays will be reduced in the immediate future as follows (dollars in millions):

1987	1988	1989	1990	1991	1992	1993	1994	1995
---	-127	-145	-120	-112	-193	-260	-392	-478

Disadvantages:

1. Costs are slightly higher than direct appropriations and FFB alternatives, as municipalities will have to pay between 50 to 100 basis points above rates available to the federal government.

2. In some cases it may be difficult to obtain local support.

Lease back buildings from developers under purchase agreement

This transaction would be structured such that the federal government owned the land and leased the improvements on the land from a developer who would obtain low cost financing for the project on the basis of GSA's lease commitment. GSA would then purchase the facility at the end of 30 years from the developer for nominal consideration ($1,000).

Advantages:

1. The government would gain most of the financial advantages of ownership. Savings would be approximately the same as those under a lease through municipalities. Borrowing costs would be lower than those incurred without the lease guarantee. Further, we would avoid state and local property taxes and gain asset appreciation.

2. This option spreads the cost of the building over the life of the lease. Private sector financing is used, and there is no short-term increase in federal outlays. GSA estimates that the ten year outlay savings will be the same as under the municipality approach.

Disadvantages:

1. Costs are slightly higher than under the direct appropriation and FFB alternatives, as borrowing costs are estimated to be an additional 50 to 100 basis points.

The following represent 30-year discounted savings for the acquisition of a single building (Oakland) under the alternative financing mechanisms described above (dollars in millions):

Leased by federal government (base costs)...$235

Savings from alternatives:

a. Acquired/direct appropriation............$111
b. Acquired/federal financing bank.......... 109
c. Lease and then acquire through
    municipality........................... 100
d. Lease with purchase agreement from
    developer.............................. 100

Conclusions and Recommendations

GSA has concluded that there are significant savings to the taxpayer from greater ownership and improved management of federal buildings. GSA recommends:

1. Continue vigorous effort to reduce space requirements, with a goal of 135 square feet per person.

2. Implement a collocation policy, where agencies develop plans to consolidate operations and GSA assists agencies in accomplishing those plans. Focus efforts on the National Capital Region, moving to consolidate major Departments.

3. Pursue a policy of greater ownership of federal buildings. Begin immediately to use municipal funding alternative and lease back from private developers on a case-by-case basis where it can be shown that it is cheaper than leasing. OMB would continue to review the economics of each individual project.

4. Explore using the Federal Financing Bank with OMB and Treasury. If viable, this strategy should be reflected in the FY 1987 budget and legislative program.